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IN THE

Supreme Court of the United States

No. 556 OCTOBER TERM, 1956

HENRY B. MIKELBERG and ROSE R. MIKELBERG,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HENRY B. MIKELBERG,
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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ROSE R. MIKELBERG,
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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioners, Henry B. Mikelberg and Rose R. Mikelberg, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above entitled cases on June 5, 1956, which affirmed the decisions of the Tax Court of the United States.

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Citation to Opinion Below

The opinion of the United States Court of Appeals for the Third Circuit, printed in Appendix B hereto, *infra,* is reported in 234 Fed. (2d) 34.

Jurisdiction

The judgment of the United States Court of Appeals for the Third Circuit was entered on June 5, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. A., Sec. 1254.

Questions Presented

I. Whether the manner in which the net worth method of reconstructing income was applied was not calculated to produce an arbitrary and excessive determination of taxable income.

II. Whether the Commissioner sustained the burden of proof of fraud.

Statute Involved

The statute involved is the following sections of the Internal Revenue Code of 1939, and the corresponding sections of the Internal Revenue Code of 1954 are indicated in parentheses with respect to each section: Sections 41 (441, 446), 272(e) (6214(e)), 275(a) and (c) (6501(a) and (e)), 276(a) and (b) (6501(c)), 293(c) (6653(b)) and 1112 (7454(a)).

Statement of the Cases

These cases, which have been consolidated for argument and brief, involve the income tax and fraud penalty liabilities of Dr. Henry B. Mikelberg and Dr. Rose R. Mikelberg, husband and wife, for the calendar years 1944 to 1949, inclusive. They filed joint income tax returns for each of the years 1944, 1945, 1948 and 1949. They filed separate income tax returns for each of the years 1946 and 1947. The opinion of the Tax Court is reported in 23 TC 342. The decisions of the Tax Court were entered on June 8, 1954. The petitions for review were filed on September 1,

1955. The judgment of the United States Court of Appeals for the Third Circuit affirming the decisions of the Tax Court of the United States was entered on June 5, 1956. A Petition for Rehearing was filed on June 19, 1956, which was denied on June 26, 1956. The jurisdiction of this Court rests upon Section 1254 of the Judicial Code.

Originally the cases involved issues concerning the propriety of using the net worth method of computing the income of taxpayers; of making an allocation of the joint income so found between taxpayers for the years 1946 and 1947; the amount of certain items, such as opening cash on hand and living expenses, and the course of other items, such as savings bank deposits and savings bonds in the name of petitioners' daughter, to be included in the computation of income by the net worth method; the correctness of the Commissioner's determination of fraud; and the statute of limitations. The Tax Court increased the opening cash on hand of taxpayers as of the beginning of the taxable period involved, to the sum of $22,000 as opposed to $15,000 originally determined by the Commissioner in his deficiency notices. The Tax Court decided the remaining issues in favor of the Commissioner.

Petitioners do not claim that the use of the net worth method of computing their taxable income was an improper method. However, petitioners contend that the net worth method as applied by the Commissioner, the Tax Court and the United States Court of Appeals, resulted in an arbitrary and excessive determination, and that there was an insufficient sum fixed as their net worth at the beginning of the tax period in question. Thus there is here involved the question of the proper application of the net worth method and the question of fraud. The facts as found by the Tax Court with respect to the matters now in contest are substantially as follows.

Petitioners, Dr. Henry B. Mikelberg and Rose R. Mikelberg are husband and wife, residing in Philadelphia, Pennsylvania.

They filed joint income tax returns for the taxable years 1944, 1945, 1948 and 1949 and separate income tax returns for the taxable years 1946 and 1947 with the collector of internal revenue for the first district of Pennsylvania, in Philadelphia.

Both petitioners are doctors of medicine and are licensed to practice medicine in Pennsylvania. Henry was born in 1894 and received his license to practice in Pennsylvania in 1920. Although not certified as a specialist, his practice during the taxable years was largely in the fields of gynecology and obstetrics. Rose was born in 1903 and received her license to practice in Pennsylvania in 1930. Her practice during the taxable years was limited to pediatrics, but she has not been certified as a specialist in said field. Petitioners were married in 1929 and have one daughter, Elinor, who at the time of the hearing was 23 years of age and was attending medical school.

Henry was graduated from medical school in 1917, where he had received some financial assistance from scholarships. He also worked as a clerk in a haberdashery during the period 1907-1917, beginning at $3 a week and later earning as much as $35 to $50 a week, depending upon the amount of time worked. During this period he lived at home with his family. His father worked in a factory as a cigar maker. Four other children also resided at home and contributed to the support of the household.

Henry served his internship from 1917 to 1918, and thereafter entered the Army. He returned from France and was discharged in August, 1919. Thereafter, he opened an office for the private practice of medicine.

Henry filed individual income tax returns for the years 1925 to 1937, inclusive. The number of dependents reported thereon, and tax reported as due, and paid, which varied from zero to an amount not in excess of $64.94 for any one of the years, is set forth in a schedule in the decision of the Tax Court. He claimed his mother, Emma Mikelberg, as his only dependent for the years

1918-1930, inclusive. For the years 1929-1937, he reported his wife, Rose, as an exemption, and for the years 1931 and 1933-1937, he claimed his mother and daughter as dependents.

Rose never filed an individual income tax return either jointly or separately up to and including the taxable year 1937.

Henry and Rose filed joint returns for the years 1938-1940, inclusive. The number of dependents reported thereon, and the taxes reported as due and paid were as follows:

Year	*Number of dependents*	*Taxes reported and paid*
1938	2 (Emma and Elinor)	$12.62
1939	1 (Elinor)	9.18
1940	1 (Elinor)	29.70

Petitioners also filed joint returns for the years 1941-1943, inclusive, reporting net income as follows:

Year	*Net income*
1941	$2,587.08
1942	3,573.63
1943	3,944.14

On June 22, 1929, a judgment was entered against Henry in favor of the Felix Building and Loan Association in the amount of $25,000. This judgment arose out of a bond and mortgage transaction between Henry's brother and the association wherein Henry was surety for his brother's obligation of $25,000. This judgment was satisfied on or about May 15, 1946, by Henry's payment of $200 to United Trading Corporation, successor in interest to the association.

During the period that the judgment was in effect, Henry attempted to conceal assets in order to prevent an execution to satisfy the judgment. In furthering this attempt, property was purchased in his wife's name; however, other property was purchased in both of their names jointly, and some securities and property was purchased by him in his own name.

Henry was advised by counsel in 1944 that a settlement could be made on said judgment.

During the taxable years Henry had office hours morning and afternoon and made few outside calls. He also delivered about 50 or 60 babies a year. Rose devoted less time to her practice than Henry spent in his practice. She had regular visiting hours during the week from two o'clock to four o'clock every afternoon. She also made house calls and devoted some time to work in hospital clinics for which latter she received no compensation. All of the receipts from her practice were turned over by her to her husband.

Petitioners have no books and records showing the receipts from or expenses incurred in their medical practices.

It was stipulated by the parties that on January 1 of each of the years 1944 to 1950, inclusive, petitioners owned assets acquired with their own funds, exclusive of cash on hand, and exclusive of other assets the petitioners might have acquired with their own funds in the name of another, in the total amount as follows, a breakdown of said amounts being set forth in a schedule in the decision of the Tax Court.

1944	$ 76,414.40
1945	125,393.85
1946	153,972.52
1947	171,183.44
1948	193,552.15
1949	202,649.09
1950	224,071.35

of which the real property owned by the petitioners is included in the following amounts:

1944	$ 63,150.00
1945	120,113.53
1946	143,659.36
1947	155,659.36

1948	179,264.36
1949	188,794.14
1950	204,094.14

The real property owned by petitioners on January 1, 1944, consisted of one parcel purchased in 1919, two in 1936, one in 1940, two in 1941 and one in 1943. During various months of 1944, petitioners purchased eleven other parcels of real property. No mortgages were payable by petitioners on any of the properties purchased by them during 1944.

Petitioners had accumulated cash on hand on January 1, 1944, in the amount of $22,000.

A school savings account in the name of petitioners' daughter, Elinor Mikelberg, showing deposits for the period January 1, 1944, to August 24, 1948, and for the period August 26, 1948, through 1949, are set forth in a schedule in the decision of the Tax Court, a summary of which is as follows:

1944	$ 00.00
1945	35.95
1946	54.95
1947	676.89
1948	333.00
Transferred to regular savings account August 26, 1948	$1,100.79
September, 1948-December, 1948	286.30
1949	1,595.00
Total	$2,982.09

All of the deposits in both accounts were made with funds furnished Elinor by petitioners.

Petitioners paid for the following amounts (at cost) of United States Government Bonds (Series E) in the name of their daughter, Elinor, during the years indicated:

1944	$ 468.75
1945	675.00
1946	1,050.00
1947	2,362.50
1948	3,731.25
1949	3,787.50
1950	3,825.00

All such bonds were paid for with their own funds.

The parties stipulated that petitioners had liabilities (including reserves for depreciation) on January 1, of the years indicated, which, in total, are as follows:

1944	$25,949.57
1945	34,529.02
1946	38,315.70
1947	30,289.64
1948	28,520.97
1949	23,753.16
1950	26,353.26

The $25,000 judgment against Henry is not reflected in the above schedule.

During the taxable years petitioners resided on the second floor of a building which they owned, and maintained their offices on first floor. They had a part-time maid, who worked four or five hours per day throughout the taxable years. Her duties included cleaning the offices as well as doing personal laundry of the petitioners and their daughter. Her salary was between $15 and $20 per week throughout the taxable years.

The Commissioner determined that petitioners' living expenses were as follows:

1944	$2,500
1945	2,800
1946	3,100
1947	3,400
1948	3,700
1949	4,000

They incurred living expenses during the taxable years in amounts at least as great as those determined by the Commissioner.

Petitioners' net worth was as follows on January 1 of each of the years indicated:

1944	$ 72,933.58
1945	91,539.83
1946	116,742.77
1947	143,347.20
1948	169,530.22
1949	184,070.52
1950	204,525.18

Petitioners made the following Federal income tax payments to the collector of internal revenue at Philadelphia, Pennsylvania, in the taxable years 1944 through 1949:

Year	*Payments*
1944	$1,324.71
1945	1,101.66
1946	2,518.69
1947	4,987.88
1948	4,714.88
1949	5,668.30

During the taxable years 1944 through 1949 the petitioners realized the following long-term capital gains:

Year	*Capital Gains*
1944	$ 945.98
1945	1,078.90
1946	00.00
1947	00.00
1948	2,995.74
1949	00.00

For Federal income tax purposes during those taxable years, 50 percent of such long-term capital gains is taken into account.

Petitioners had a combined net income in the following amounts during the years stated:

1944	$21,957.97
1945	28,565.15
1946	32,223.12
1947	34,570.90
1948	21,457.31
1949	30,122.96

For the years 1946 and 1947 the combined net income shown above is allocable to Henry and Rose as follows:

	Henry	*Rose*
1946	$22,556.18	$ 9,666.94
1947	24,199.63	10,371.27

Petitioners reported net income as follows in their joint income tax returns for the years 1944, 1945, 1948 and 1949:

1944	$ 7,961.71
1945	9,523.34
1948	18,960.69
1949	18,822.44

Petitioners reported net income as follows on their separate income tax returns for the years 1946 and 1947:

	Henry	*Rose*
1946	$11,657.05	$5,212.45
1947	13,895.41	6,300.00

"Consents Fixing Period of Limitation upon Assessment of Income and Profits Tax" were filed by petitioners for the taxable years 1945-1948, inclusive, as follows:

Tax Year	*Petitioner*	*Date Executed*	*Period of Limitations Extended Until*
1945	Henry B. & Rose R. Mikelberg	2-1-51	6-30-52

1945	Henry B. & Rose R. Mikelberg	1-8-52	6-30-53
1946	Henry B. Mikelberg	1-8-52	6-30-53
1946	Rose R. Mikelberg	1-8-52	6-30-53
1947	Henry B. Mikelberg	2-1-51	6-30-52
1947	Henry B. Mikelberg	1-8-52	6-30-53
1947	Rose R. Mikelberg	2-1-51	6-30-52
1947	Rose R. Mikelberg	1-8-52	6-30-53
1948	Henry B. & Rose R. Mikelberg	1-8-52	6-30-53

The notices of deficiency herein were mailed on August 29, 1952.

The Tax Court further found that the testimony of petitioners was unreliable and unworthy of belief in many respects, and was false or exaggerated with respect to an $82,000 accumulation of cash on hand at the beginning of the taxable period as claimed by petitioners, but did find the accumulation of such cash on hand to be in the amount of $22,000. The Court concluded that it was entirely appropriate to determine the increase of net worth of the composite assets of both petitioners in computing the composite net income to be attributed to both petitioners for each year of the taxable period, and that for the years for which they filed joint income tax returns, such composite income figure applied, and that for the years for which petitioners filed separate returns, a reasonable basis existed in the evidence to allocate composite income 30 percent to Rose and 70 percent to Henry.

The Tax Court finally found and concluded that since petitioners were both doctors of medicine, were intelligent persons, maintained no books and records from which their income could be determined, were not cooperative with the investigating agents, were frequently vague and evasive in their testimony at the trial, had substantially understated their net income in each of the taxable years and varied their explanations of their assets from time to time, the Commissioner sustained his burden of proof by clear and convincing evidence that the deficiencies for each of the taxable years were due, at least in part, to fraud with intent to evade tax.

From the decisions entered by the Tax Court, affirming the determinations of the Commissioner, petitioners appealed to the United States Court of Appeals for the Third Circuit. That Court affirmed the decisions of the Tax Court on June 5, 1956. From said decision of the United States Court of Appeals for the Third Circuit petitioners file this Petition for Writ of Certiorari.

Reasons for Granting the Writ

I. This case presents an important question relating to the application and use of an increase in the combined net worth of husband and wife petitioners, both doctors of medicine, to determine the separate taxable income of each.

II. The Commissioner did not sustain the burden of proof of fraud.

I.

This case presents an important question relating to the application and use of an increase in the combined net worth of husband and wife petitioners, both doctors of medicine, to determine the separate taxable income of each.

Petitioners' income was derived, throughout the taxable period of 1944-1949, inclusive, entirely from their medical practices and rental real estate, except for relatively minor amounts of capital gains. They filed joint income tax returns for the years 1944, 1945, 1948 and 1949. They filed separate income tax returns for the years 1946 and 1947. The tax returns revealed acquisitions of real estate totaling over $140,000 in the years in dispute, whereas the combined net income reported during the same period was only around $92,000. Petitioners maintained no books or records revealing their receipts or expenses as medical practitioners.

Petitioners do not contend that it was not proper for the Commissioner to resort to, nor for the Tax Court to allow, the net

worth method of computation of income, after making appropriate adjustments for non-deductible living expenses, non-taxable items, etc., to show allegedly understated income. Cf. *Holland* v. *U. S.*, 348 U. S. 121 (1954); *Archer* v. *Commissioner*, 227 F. 2d 270 (CA-5, 1955).

However, petitioners contend that the manner in which the Tax Court allowed the net worth method to be applied, with no consideration as to the time of receipt of alleged income with the time of admitted expenditures, and without separating ownership and taxability of rental income derived from the practice of medicine, resulted in an arbitrary and excessive determination of taxable income, which required remand to the Tax Court for further hearing on the points involved. *Gasper* v. *Commissioner*, 225 F. 2d 284 (CA-6, 1955); *Durkee* v. *Commissioner*, 162 F. 2d 184 (CA-6, 1947); *Federal National Bank of Shawnee* v. *Commissioner*, 180 F. 2d 494 (CA-10, 1950).

1. Time of Receipt of Alleged Income Inconsistent with Time of Admitted Expenditures and Acquisitions.

The increase in net worth method of reconstructing income is based on the assumption that increases in net worth plus non-deductible expenditures are derived principally from current taxable income.

One of the most commonly used methods of reconstructing taxable income is that which is based on a reference to the increase in the taxpayer's net worth during the taxable year. In computing the increase, the taxpayer's assets are totaled and net worth as determined at the close of the previous taxable year is subtracted from the total at the close of the taxable year in question. The remainder, if any, is the increase for the taxable year and, if no adjustments are required, constitutes taxable net income.

The United States Supreme Court has approved the net worth method. But to be acceptable, the Government must (1) estab-

lish with reasonable certainty, an opening net worth, to serve as a starting point from which to compute future increases in the taxpayer's assets, and (2) introduce evidence in support of the inference that the taxpayer's net increases are attributable to currently taxable income.

Standard Federal Tax Report, C. C. H. 1956 Vol. 2, Sec. 2817.1032.

Before the net worth expenditures method of proof is effective, the net worth of the taxpayer at the beginning of the taxable year must be clearly and accurately established by competent evidence. "Essential proof of no other assets is the cornerstone of the evidence of the government."

U. S. v. *Fenwick*, 177 Fed. (2d) 488.

Where the time of the receipt and expenditure of the alleged income can be readily demonstrated, the net worth method must be substantiated by the existing facts throughout the taxable year, and not be arbitrarily arrived at by an opening and closing net worth.

The only sources in the case at bar from which petitioners may have derived income during the taxable years were: (1) their medical practices; (2) rental real estate; and (3) incidental sales of capital assets, which latter consisted of investment securities in 1944, and three parcels of real estate, one in 1944, one in 1945, and one in 1948. The Tax Court evidently ignored the rentals from real estate and must have considered the source of all of the income to be the medical practice of each of petitioners. While there can be no serious dispute with the conclusion, still there is no express finding on the point by the Tax Court, that the income which each petitioner individually derived from his or her separate medical practice was of a steady nature throughout each taxable year.

Petitioners submit that there is a reasonable basis for their contention that their receipts as medical doctors were steady and

uniform throughout each taxable year and that the Tax Court misapplied the net worth method in overlooking this point.

With respect to the rental income, it is usually received with periodic uniformity. As each new rental property was acquired, total rental income naturally increased, which gave petitioners a larger percentage of each year's rental income in the latter part of the year, thereby leaving a lesser percentage of the total year's rental income available for expenditures in the early months of the year.

Thus petitioners urge that any additional unreported income attributed to them by the net worth method of determination approved by the Tax Court, must be deemed to be of a steady and non-fluctuating nature in each of the taxable years involved, and should have been so found by the Tax Court.

The record indicates that the increases in net worth in each year resulted from the acquisition of real estate, the dates of which are susceptible of direct proof, which appear on the rental and depreciation schedules attached to the tax returns filed during the period, and from the reduction of mortgage and loan liabilities, which dates also are capable of being determined accurately. The non-deductible living expenses are non-fluctuating in the respective years. The Tax Court apparently ignored these facts.

If the alleged income could not support the admitted acquisitions and expenditures at any one period of time throughout any particular tax year, then it follows that the ultimate determination is erroneous. Inasmuch as there were no receipts of such non-taxable items as gifts, inheritances, etc., during the taxable period, the error must of necessity exist in the amount of assets to be attributed in the opening net worth. It goes without saying that if petitioners had, as they contend, a large accumulation of cash on hand for which they were given insufficient credit, such an accumulation could have been the source of funds for acquisition of property or other expenditures at times when their current income would not be sufficient for such purposes.

Practically all of the items in the net worth computations were stipulated to be correct, except cash on hand, bonds and bank accounts in the name of petitioners' daughter, and living expenses. The two latter items were not contested. Thus the only item in dispute is the amount of cash on hand at the beginning of the period. The Commissioner allowed petitioners $15,000 in the deficiency notices while petitioners claimed $82,000. The Tax Court determined the sum of $22,000 and it is petitioners' contention that in this respect the Tax Court acted arbitrarily.

It is readily apparent as to the arbitrary way in which the Tax Court allowed the net worth computation with an opening cash amount of only $22,000.

In Exhibit A to the Commissioner's Computation for Entry of Depreciation, the entire $22,000 cash item and proceeds from the sale of stock of $8,610.13 in the opening net worth were consumed by the acquisition of eleven properties and in the other expenditures comprising the increase in composite net worth for 1944, which left petitioners with no cash on hand and but $405.32 cash in bank with which to begin the year 1945. Petitioners acquired an x-ray machine for $2,899.27 and real estate for $24,500. The only available source of funds for said acquisitions, exclusive of current income from petitioners' professions and rental real estate, and exclusive of cash on hand not credited to them, was a $2,000 increase in loans payable to the Colonial Trust Co., Wilmington, Del., and the net proceeds of the sale of a property shown on the tax return as having occurred on February 8, 1945, amounting to $3,700, which represented the approximate net sales price of $9,500 less the amount of a mortgage satisfied of $5,800, or total cash available from non-current income of about $5,700.

In addition to this acquisition of property for a total of $27,399.27, petitioners expended approximately $1,342.41 for living expenses and taxes.

According to the Tax Court's opinion, petitioners had a total current cash income for the full year of $32,266.28. Five-twelfths of this income was earned in the five-month period up to June 1 or the sum of $13,444.29 plus cash available from a possible $2,000 loan, $3,700 from the sale of a property and opening cash in bank of $405.32 or a total of only $19,549.21 available for the $28,744.68 disbursed in this same period.

Thus according to the Tax Court's opinion, petitioners expended at least $9,192.07 more than their reconstructed income during the period to June 1, 1945. Since petitioners made only one additional acquisition in September, 1945, for $2,611.58 cash, the net worth computation would balance out at the end of the year, inasmuch as seven-twelfths of their annual income can make up the earlier deficiency. Thus petitioners must have had the $9,192.67 as cash on hand at the beginning of 1945, for which neither the Commissioner nor the Tax Court gave them proper credit.

Thus it is apparent from the examination of this one year that it is necessary to combine the time of acquisition of assets and other expenditures with the time of receipt of current taxable income. The Tax Court failed to so make a proper allocation of the net worth method, which constitutes reversible error.

It has been held that the Commissioner was justified in computing by the net worth method the income of taxpayers, a physician and his wife. But he erred in not allowing some part of the undeposited cash in a safety deposit box as cash on hand at the beginning of the net worth period.

James O. Miles Est., 14 T. C. M. 237, Dec. 20,935 (M) T. C. Memo 1955-75.

Similarly, where undeposited cash on hand at the end of each year was not taken into account where the Tax Court determined under the Cohan rule, including exempt income received from services in the Army.

Harry Gleiss, 247 T. C. 941, Dec. 21,204.

The determination of taxpayers' income for 1947 and 1948 by the net worth and expenditures method was erroneous, it having been found by the Tax Court that the taxpayer did not disclose to her former accountant, who testified for the Government all of her assets in 1947, and that she had at that time sufficient assets to cover her disbursements in the taxable years.

Etta H. Harvey, 13 T. C. M. 716, T. C. Memo 1954-13.

The Commissioner's reconstruction on the basis of net worth increase was denied, the taxpayer, a Seattle doctor, having convinced the Court that the beginning net worth should be increased by $75,000 cash brought with him to Seattle prior to the taxable years.

Maurice A. Spalding, 12 T. C. M. 883, Dec. 19,832 (M.).

The Commissioner's reconstruction of net income of a doctor by the use of the net worth method was rejected, where the taxpayer's testimony disclosed that his cash holdings at the beginning of the period under review were substantially understated by the Commissioner.

William L. Drake, 11 T. C. M. 1086, Dec. 19,278 (M.).

The same was held where the Court found that the Commissioner had not properly credited the taxpayer with some $79,000 in cash savings at the beginning of the taxable period.

Oscar L. Bowman, 14 T. C. M. 46, Dec. 20,827 (M.), T. C. Memo 1955-14.

In using the net worth expenditures method of establishing net income, it was "essential for the Government to present evidence that excluded, or tended to exclude, other available sources from which the additional funds expended could have been derived."

J. Baker Bryan v. *U. S.,* 175 F. (2d) 223.

U. S. v. *Fenwick, supra.*

2. **The Allocation of the Composite Net Income Between the Petitioners for the Years They Filed Separate Income Tax Returns Was Arbitrary and Erroneous.**

As was stated previously, petitioners filed separate income tax returns for 1946 and 1947. In these years their income was derived entirely from their medical practices and from rental real estate. The Tax Court held that the increase in the net worth of the composite assets could be used in determining petitioners' composite net income for each of the two years and that there was reasonable basis in the testimony for allocating 30 percent of said income to Rose and 70 percent to Henry. Petitioners contend that the Tax Court was entirely capricious in making such an arbitrary 30-70 percent allocation.

The Tax Court overlooked entirely rental income in arriving at said allocation. In 1946 net rental income was $10,144.50 and in 1947 was $10,658.47 on Henry's return. Henry reported said years as net profit from his medical practice the sums of $2,012.55 and $3,736.93, respectively. Rose reported gross receipts only from her medical practice the sums of $5,712.45 and $6,800, respectively. The net profit from the combined medical practice of both petitioners was not as large for either of the two years as the respective net income from rentals.

After finding that petitioners pooled their assets, the Tax Court decided that whether a particular piece of real estate was acquired by them in both names or in the name of one of them alone had no significance. To be consistent, the Tax Court should have found that one-half of the rental income was allocable to each of petitioners. The Tax Court then could have determined what percentage of allegedly understated income resulted from the respective medical practice of each petitioner and from rental real estate. Instead of so finding, the Tax Court, in arriving at the

30-70 percent allocation, arbitrarily assumed that all of the income in each of the taxable years resulted only from petitioners' medical practices. It is apparent that Tax Court lost sight of the fact that the bulk of Henry's net income was derived from rental real estate and that only a minor percentage of same was realized from his practice of medicine.

Petitioners therefore contend that the Tax Court should have found the extent of ownership of each of petitioners in each particular piece of real estate. The Tax Court then would inevitably have had to find in considering the pooling of assets as equivalent to an equal one-half ownership in each parcel of real estate, that the allocation of the separate income of each petitioner had to be one-half of the rental income for the years 1946 and 1947. Thus an allocation of 30 percent of the professional income to Rose would result in her having more of the combined income with less to Henry, and hence Henry would have a correspondingly lower deficiency than the increase to Rose, because he would thereby be put in a higher surtax bracket by such an improper allocation by the Tax Court.

Petitioners contend that the allocation of the combined income between each of them by the employment of the increase in the composite net worth without considering the extent of each one's ownership of real estate and the separate taxability of the rental income derived therefrom was arbitrary, capricious and erroneous for the years 1946 and 1947. This, taken in conjunction with the application of the net worth method without attempting to combine the time of the receipt of current income with the time of admitted expenditures, resulted in an excessive and arbitrary determination of taxable income.

In *Thomas* v. *Commissioner,* 223 F. 2d 83 (C. A.-6, 1955), the Court stated:

> " . . . where it is apparent from the record that the Commissioner's determination is arbitrary and excessive, the tax-

payer is not required to establish the correct amount that lawfully might be charged against him, and he is not required to pay a tax that he obviously does not owe. In proceedings before the Tax Court as distinguished from suits for refund presented in the District Court, it is sufficient to show that the Commissioner's determination is invalid. Upon such a showing, the case should be remanded to the Tax Court for further hearings on the point involved."

II.

The Commissioner did not sustain the burden of proof of fraud.

The Tax Court decided that petitioners, both medical doctors, were intelligent persons, maintained no books or records, from which their income could be determined, were uncooperative with the investigating agents, were frequently vague and evasive in their testimony at the trial, varied their explanations of their assets from time to time, and had substantially understated their net income in each of the taxable years. It concluded that the Commissioner sustained his burden of proof under Section 1112 of the Internal Revenue Code by clear and convincing evidence that each of the deficiencies was due, at least in part, to fraud with intent to evade tax. Petitioners deny that either of them was guilty of fraud either for the years they filed joint returns or separate returns. The fraud, if any, of the one petitioner cannot be charged to the other for the years 1946 and 1947 in which they filed separate income tax returns. The Tax Court failed to observe this rule.

1. Rose

Both agents, regular and special, testified that they never had a conference with Rose or questioned her at all. Moreover, the agents said nothing about Rose's attitude as to whether it was uncooperative or antagonistic.

There is nothing whatsoever to indicate that Rose was responsible for substantial understatements, if there were any, for the years for which joint income tax returns were filed. On the other hand, in the Commissioner's audit of the years 1946 and 1947, he found that Rose had reported too much of the composite income each year and accordingly allowed her a refund for one of said years and a credit for overassessment for the other.

Petitioners contend that the Commissioner has not sustained the burden of proof of fraud with respect to Rose.

2. Henry

Petitioners contend that no fraud with intent to evade tax was proven against Henry with respect both to joint returns and separate returns.

Marcella v. *Commissioner*, 222 Fed. (2d) 878 (CA-8, 1955).

The tax returns filed in each of the years in question, contained, in rental and depreciation schedules attached thereto, complete and detailed information relative to the cost and acquisition of each parcel of real estate. Thus there was no attempt to conceal the increase in petitioners' composite net worth.

While the Tax Court emphasized failure to keep books and records, it did not consider that the bank deposit statements, check book stubs and cancelled checks, constitute a form of original records. Moreover, it did not consider the failure of the Commissioner to indicate what type of records were used to terminate the prior tax audit of the years 1946, 1947 and 1948, or if none were produced, what basis was so employed.

The allegedly substantial and consistent understatement of income alone is not sufficient to justify a finding of fraud.

Wisely v. *Commissioner*, 185 Fed. (2d) 263, (CA-6, 1950).

Kashat v. *Commissioner*, (CA-6, 1956) (1956 CCH Stand. Fed. Tax Rep. Section 9211).

In the Wisely case the Court held that in determining whether the taxpayer, a physician, filed fraudulent income tax returns for the years 1943 to 1945, inclusive, and was liable for fraud penalties, the fact that the taxpayer personally was busy to the point of distraction was vitally material. In that case, the record established that the finding of the Commissioner that the taxpayer, a physician, assessed with penalties was guilty of filing false and fraudulent income tax returns for each of the years 1942 to 1945, inclusive, was clearly erroneous.

Petitioners contend that the method employed by the Commissioner was too arbitrary to justify the finding of fraud. See *Drieborg* v. *Commissioner,* 225 Fed. (2d) 216 (CA-6, 1955). Thus petitioners contend that the Commissioner has not sustained the burden of proof of fraud with respect to either Henry or Rose.

Conclusion

For the above stated reasons, the petitioners pray that a Writ of Certiorari issue to the United States Court of Appeals for the Third Circuit to review its judgment.

Respectfully submitted,

WILLIAM A. VALENTINE
Counsel for Petitioners.

HON. JOHN H. CONNAUGHTON
Of Counsel.

Appendix A

Statute Involved.

INTERNAL REVENUE CODE

Sec. 41—GENERAL RULE

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be), in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. . . .

* * *

Sec. 272—PROCEDURE IN GENERAL

* * *

(e) INCREASE OF DEFICIENCY AFTER NOTICE MAILED.—The Board shall have jurisdiction to redetermine the correct amount of the deficiency, even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

* * *

Sec. 275—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

Except as provided in section 276—

(a) GENERAL RULE.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period. . . .

(c) OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * *

Sec. 276—SAME—EXCEPTIONS

(a) FALSE RETURN OR NO RETURN.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) WAIVER.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

* * *

Sec. 293—ADDITIONS TO THE TAX IN CASE OF DEFICIENCY

* * *

(b) FRAUD.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

* * *

Sec. 1112—BURDEN OF PROOF IN FRAUD CASES

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof of such issue shall be upon the Commissioner.

Appendix B

UNITED STATES COURT OF APPEALS
For the Third Circuit

No. 11,746

HENRY B. MIKELBERG and ROSE R. MIKELBERG,
His Wife

Petitioners.

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 11,747

HENRY B. MIKELBERG,

Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 11,748

ROSE R. MIKELBERG,

Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION TO REVIEW DECISIONS OF THE
TAX COURT OF THE UNITED STATES

ARGUED MAY 9, 1956
BEFORE GOODRICH, KALODNER AND HASTIE,
Circuit Judges

OPINION OF THE COURT
(Filed June 5, 1956)

Per Curiam

This is an appeal from a decision of the Tax Court which affirms certain deficiencies and penalties assessed against the taxpayers for the taxable years 1944 through 1949. The taxpayers are practicing physicians. They kept no books and the government's case depended largely on the net worth method of establishing deficiencies. The taxpayers do not claim that under the circumstances this was an improper method. They do claim, and their case is very ably presented, that there was an insufficient sum fixed as their net worth at the beginning of the tax period in question. There are no new principles of law involved in the case. The questions turn on various matters of fact, some of which were presented by the testimony of the taxpayers themselves. A reading of the whole record leads us to believe that the trial judge was exceedingly generous in his treatment of them. His conclusion "that their testimony was unreliable and unworthy of belief in many respects" is abundantly established by a reading of the record.

The decision of the Tax Court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS

For the Third Circuit

No. 11,747

HENRY B. MIKELBERG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: GOODRICH, KALODNER and HASTIE, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:

IDA O. CRESKOFF,

Clerk.

June 5, 1956

UNITED STATES COURT OF APPEALS

For the Third Circuit

No. 11,748

ROSE R. MIKELBERG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

Present: GOODRICH, KALODNER and HASTIE, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby affirmed.

Attest:
IDA O. CRESKOFF,
Clerk.

June 5, 1956

UNITED STATES COURT OF APPEALS

For the Third Circuit

No. 11,747

HENRY B. MIKELBERG,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 11,748

ROSE R. MIKELBERG,

Petitioner.

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

SUR PETITION FOR REHEARING

Present: GOODRICH, KALODNER and HASTIE,
Circuit Judges

After due consideration, the Petition for Rehearing on the above entitled cases is hereby denied.

BY THE COURT

/s/ HERBERT F. GOODRICH,
Circuit Judge.

June 26, 1956

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 556

HENRY B. MIKELBERG AND ROSE R. MIKELBERG, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

HENRY B. MIKELBERG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ROSE R. MIKELBERG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 267a–285a) are reported at 23 T. C. 342. The opinion of the Court of Appeals (Pet. 26–27) is reported at 234 F. 2d 34.

JURISDICTION

The judgments of the Court of Appeals were entered June 5, 1956. (Pet. 28–29.) Taxpayers' petition for rehearing was denied on June 26, 1956. (Pet. 30.) The petition for a writ of certiorari was filed on November 8, 1956, pursuant to an extension granted by this Court. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether, as held by both courts below, the manner in which the Commissioner determined deficiencies in taxpayers' income for the years 1944 to 1949, inclusive, by use of the net worth method, was correct.

2. Whether the Commissioner properly found that part of the deficiency for each taxable year was due to fraud with intent to evade tax.

STATUTES AND REGULATIONS INVOLVED

Sections 21 (a), 22 (a), 24 (a), 41, 51 (a) and (b), 54 (a) and (b), 276 (a) and (b), and 293 (b) of the Internal Revenue Code of 1939; Section 7454 (a) of the Internal Revenue Code of 1954; and Sections 29.41–3 and 29.54–1 of Treasury Regulations 111 are set forth in the Appendix, *infra,* pp. 17–22.

STATEMENT

Some of the facts were stipulated (R. 14a–21a), incorporated by reference in the findings of fact of the Tax Court (R. 267a–280a), and may be summarized as follows:

Taxpayers Henry and Rose Mikelberg were married in 1929. During the taxable years 1944 to 1949, and

for some years prior thereto, they were both engaged in the practice of medicine in Pennsylvania. Henry, who was born in 1894, received his license to practice in 1920. Rose, who was born in 1903, received her license to practice in 1930. Although neither had been certified as a specialist, Henry's practice during the taxable years was largely in the fields of gynecology and obstetrics and Rose's practice was limited to pediatrics. They had one daughter, Elinor, who at the time of the hearing was 23 years of age and was attending medical school. (R. 268a.)

Henry was graduated from medical school in 1917, where he had received some financial assistance from scholarships. Also indicative of his financial background is the fact that he worked as a clerk in a haberdashery during the period 1907 to 1917, beginning at $3 a week and later earning as much as $35 to $50 a week, depending upon the amount of time worked. During this period he lived at home with his family. His father worked in a factory as a cigar maker. Four other children also resided at home and contributed to the support of the household. (R. 268a.)

Henry served his internship from 1917 to 1918, and thereafter entered the Army. He was discharged in August 1919 and thereafter opened an office for the private practice of medicine. (R. 268a.)

Except for 1932, for which he filed no return, Henry filed individual income tax returns for the years 1925 to 1937. On those returns, however, he did not report or pay any tax for the years 1925, 1926, 1928 to 1931;

for the remaining years he reported and paid a tax as follows: 1927, $3.68; 1933, $64.94; 1934, $23.17; 1935, $36.03; 1936, $8.16; 1937, $23.29. (R. 268a–269a.)

Up to and including the taxable years 1937, Rose never filed an individual income tax return either jointly or separately. (R. 269a.) For the years 1938 to 1940, taxpayers filed joint returns in which they reported and paid taxes in the following amounts: 1938, $12.62; 1939, $9.18; 1940, $29.70. (R. 269a.) Taxpayers also filed joint returns for the years 1941 to 1943 in which they reported the following net income: 1941, $2,587.08; 1942, $3,573.63; 1943, $3,944.14. (R. 269a–270a.) Taxpayers filed joint returns for the taxable years 1944, 1945, 1948, and 1949, and separate income tax returns for the taxable years 1946 and 1947 in which they reported income as hereinafter shown. (R. 268a, 279a.)

On June 22, 1929, a judgment was entered against Henry, in favor of the Felix Building and Loan Association in the amount of $25,000. This judgment arose out of a bond and mortgage transaction between Henry's brother and the association wherein Henry was surety for his brother's obligation of $25,000. This judgment was satisfied on or about May 15, 1946, by Henry's payment of $200 to United Trading Corporation, successor in interest to the association. (R. 270a.)

During the period that the judgment was in effect, Henry attempted to conceal assets in order to prevent an execution to satisfy the judgment. In carrying out this attempt, property was purchased in his wife's

name; however, other property was purchased in both of their names jointly, and some securities and property were purchased by him in his own name. In 1944, Henry was advised by counsel that a settlement could be made on the judgment. (R. 270a.)

During the taxable years, Henry had morning and afternoon office hours, and made few outside calls. He also delivered about 50 or 60 babies a year. Rose devoted less time to her practice than Henry spent in his practice. She had regular visiting hours during the week from two o'clock to four o'clock every afternoon. She also made house calls and devoted some time to work in hospital clinics. She received no compensation for her work in clinics. All of the receipts from her practice were turned over by her to her husband. (R. 270a.)

Taxpayers have no books and records showing the receipts from or expenses incurred in their medical practices. (R. 270a.)

On the basis of the stipulated facts and the Tax Court's findings, and pursuant to the direction of the Tax Court, the parties filed an agreed computation for entry of decision (R. 291a) which shows taxpayers' corrected net income as follows (R. 291a):

	1/1/44	1/1/45	1/1/46	1/1/47	1/1/48	1/1/49	1/1/50
	• • •	• • •	• • •	• • •	• • •	• • •	• • •
Total assets	$98,883.15	$126,068.85	$155,058.47	$173,636.84	$198,051.19	$207,823.68	$230,878.44
Liabilities	25,949.57	34,529.02	38,315.70	30,289.64	28,520.97	23,753.16	26,353.26
Net worth	$72,933.58	$91,539.83	$116,742.77	$143,347.20	$169,530.22	$184,070.52	$204,525.18
Prior year's net worth		72,933.58	91,539.83	116,742.77	143,347.20	169,530.22	184,070.52
Increase in net worth		$18,606.25	$25,202.94	$26,604.43	$26,183.02	$14,540.30	$20,454.66
Less: 50 % of long-term gain		472.99	539.45	0	0	1,497.87	0
		$18,133.26	$24,663.49	$26,604.43	$26,183.02	$13,042.43	$20,454.66
Add:							
Living expenses (estimated)		2,500.00	2,800.00	3,100.00	3,400.00	3,700.00	4,000.00
Federal income taxes paid		1,324.71	1,101.66	2,518.69	4,987.88	4,714.88	5,668.30
Corrected net income		$21,957.97	$28,565.15	$32,223.12	$34,570.90	$21,457.31	$30,122.96

* * * * * * * * * * *

Included in the "Total Assets" figures for each year are assets (bank accounts, savings bonds, real estate, stocks, and personal property) which the parties stipulated they had acquired with their own funds (R. 270a–271a);[1] bank deposits in the name of their daughter Elinor, which the Tax Court found were made from funds furnished by taxpayers (R. 275a), and United States bonds listed in the daughter's name, which the Tax Court also found were purchased with funds belonging to taxpayers (R. 276a). The total asset figure of $98,883.15 for the year beginning January 1, 1944, also reflects cash in the amount of $22,000 which the Tax Court found taxpayers had accumulated as of that date. (R. 272a.) The amount of cash on hand at the beginning of the period is the only item in this computation which is in dispute (Pet. 16).

From the total assets of the taxpayers as determined by the Tax Court were subtracted liabilities (including reserves for depreciation) in stipulated amounts. (R. 276a, 291a.) To the resulting net worth increase for each of the taxable years,[2] were added living expenses for the various years in amounts determined by the Commissioner (and which the Tax

---

[1] The real property owned by taxpayers on January 1, 1944, consisted of one parcel purchased in 1919, two in 1936, one in 1940, two in 1941, and one in 1943. During various months of 1944, taxpayers purchased eleven other parcels of real property. No mortgages were payable by taxpayers on any of the properties purchased by them during 1944. (R. 272a.)

[2] Subtracted therefrom were certain long-term capital gains. (R. 278a, 291a.)

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Court found were "at least" as great as the Commissioner determined) (R. 277a), and federal income taxes paid for those years (R. 278a).

The following tabulation shows the net income reported by the taxpayers (R. 279a) as compared with their corrected net income as found by the Tax Court (R. 278a–279a):[3]

	Net Income Reported	Net Income (Tax Court)
1944	$7,961.71	$21,957.97
1945	9,523.34	28,565.15
1946	11,657.05 (Henry)	22,556.18
	5,212.45 (Rose)	9,666.94
1947	13,895.41 (Henry)	24,199.63
	6,300.00 (Rose)	10,371.27
1948	18,960.69	21,457.31
1949	18,822.44	30,122.96

The Tax Court also found as an ultimate fact that a part of the deficiency in tax for each of the taxable years was due to fraud with intent to evade tax. (R. 280a.)

The Tax Court thereupon sustained the Commissioner's determination that taxpayers were liable for deficiencies in tax and fraud penalties for each of the years involved (R. 293a–295a), though in amounts differing from those determined by the Commissioner (R. 267a). In a *per curiam* opinion (Pet. 26–27), the Court of Appeals affirmed the Tax Court.

ARGUMENT

This case presents a question which is entirely factual and does not call for review by this Court. Both

[3] The corrected net income figures for 1946 and 1947 reflect the Tax Court's allocation between taxpayers of their combined net income for those years. (R. 279a.) This allocation attributed 70% of the combined income to Henry and 30% to Rose.

courts below concurred in finding that taxpayers had understated their income for the years involved and that the deficiency for each year was due in part to fraud with intent to evade tax. A seasoned and wise rule of this Court makes concurrent findings of two courts below final in the absence of exceptional circumstances. *Comstock* v. *Group of Investors,* 335 U. S. 211, 214. No exceptional circumstances exist here.

1. Taxpayers failed to keep any books or records revealing their receipts or expenses as medical practitioners, as required by Section 54 (a) of the Internal Revenue Code of 1939, Appendix, *infra,* p. 19, so as to enable the Commissioner to determine the correct amount of their taxable income. In the circumstances, the Commissioner had recourse to the use of the net worth method, which taxpayers admit was proper. (Pet. 12–13.) In spite of this admission, they complain that the Commissioner and the Tax Court incorrectly applied that method alleging that (Pet. 14):

> Where the time of the receipt and expenditure of the alleged income can be readily demonstrated, the net worth method must be substantiated by the existing facts throughout the taxable year, and not be arbitrarily arrived at by an opening and closing net worth.

Taxpayers thereby confuse the direct and conventional method of determining income with the use of the (indirect) net worth method and assume that the

Commissioner was able to ascertain their income and the exact time of its receipt. But the very reason for resort to the net worth method is that the source of income and the time of its receipt cannot otherwise be demonstrated.

Taxpayers' main complaint, however, relates to the amount of cash on hand at the beginning of the net worth period. (Pet. 16.) The Tax Court found that they accumulated cash on hand on January 1, 1944, in the amount of $22,000 (R. 272a), while they profess to have had $82,000 (Pet. 16). The record totally fails to disclose the accumulation of any such amount as professed.

It was stipulated that taxpayers had net assets of over $50,000 as of January 1, 1944 (R. 18a, 45a), and the Tax Court found, as shown in the agreed computation for entry of decision (R. 291a), that they had net assets, exclusive of any cash, of over $72,000. In view of the prior financial history of taxpayers see pp. 3–4, *supra,* it would appear that the Tax Court was extremely generous in finding that they had also accumulated a cash hoard by January 1, 1944 of $22,000 (R. 272a) and that there certainly is no basis for taxpayers' assertion that they had $82,000.

As in the case of *Holland* v. *United States,* 348 U. S. 121, the Government negatived the possibility of taxpayers' having accumulated such a sum by checking their income tax returns as far back as

1918,[4] and Henry's employment and earnings beginning in 1907 (R. 268a–270a), thereby demonstrating that income declared and earnings in previous years were insufficient to have enabled them to have acquired such a hoard as asserted.

Beyond that, the credibility of the taxpayers' self-serving testimony as to the existence of such a cash fund was a matter for determination by the Tax Court. In this regard, the Tax Court stated (R. 282a) that it had ample opportunity to observe taxpayers on the witness stand. As a result, it concluded that their testimony was "unreliable and unworthy of belief in many respects," "exaggerated or untruthful," "false or exaggerated," "vague," and "not credible." (R. 282a–284a.) It is well settled that the Tax Court is not required to accept such testimony, even though it may have been uncontradicted. *Quock Ting* v. *United States,* 140 U. S. 417; *Goe* v. *Commissioner,* 198 F. 2d 851 (C. A. 3d), certiorari denied, 344 U. S. 897.

Nevertheless, the Tax Court, exercising its best judgment based on the entire record, concluded that taxpayers did have an accumulated cash fund at the beginning of the net worth period of $22,000. (R. 283a). See *Goe* v. *Commissioner, supra,* pp. 852–853; *Cohan* v. *Commissioner,* 39 F. 2d 540 (C. A. 2d);

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[4] Taxpayer Rose Mikelberg did not file any returns prior to the taxable year 1938. (R. 269a.)

Chesbro v. *Commissioner,* 225 F. 2d 674 (C. A. 2d), certiorari denied, 350 U. S. 995; *Bryan* v. *Commissioner,* 209 F. 2d 822, 827–828 (C. A. 5th), certiorari denied, 348 U. S. 912. The Court of Appeals did not disturb that finding.

Taxpayers next contend (Pet. 19–21) that the Tax Court erred in determining that the composite net income of taxpayers for the years 1946 and 1947, when they filed separate returns, was allocable thirty per cent to Rose and seventy per cent to Henry. Specifically, they contend (Pet. 20) that the Tax Court should have determined the extent of each taxpayer's ownership in each piece of real estate and determined rental income for the years 1946 and 1947 on that basis—which they declare would have been fifty per cent to each.

This contention is predicated in turn upon acceptance of the premise that all rental income was reported and that, contrary to the net worth computation, rental income rather than income from the practice of medicine, constituted the major source of taxpayers' income. (Pet. 19.) The contention is also advanced in face of the fact that all rental income was reported on Henry's return.

The record shows that taxpayers pooled their assets and did not attempt to show in what proportions this had been done. The Tax Court was of the opinion that based on the evidence a seventy per cent–thirty per cent allocation between Henry and Rose was rea-

sonable. This was based in part upon the fact that Henry testified that Rose devoted about one-fifth of the time to her practice that he devoted to his (although the evidence as to office hours kept by each and house calls made by Rose suggested a higher percentage) and in part upon the fact that the net income reported by Rose was about forty-five per cent of the net income reported by Henry. (R. 281a.) By its affirmance, the Court of Appeals concurred in this finding. And see *Lias* v. *Commissioner*, 235 F. 2d 879 (C. A. 4th).

Contrary to taxpayer's contention, there is no requirement that the evidence establish the specific amounts arrived at by the Tax Court in its evaluation of the record, see *Commissioner* v. *Thompson*, 222 F. 2d 893, 895–896 (C. A. 3d), particularly in the circumstances of this case (*Goe* v. *Commissioner*, *supra*, pp. 852–853; *Archer* v. *Commissioner*, 227 F. 2d 270, 273–274 (C. A. 5th)). Taxpayers kept no books and records as required by law and have no cause to complain of the adjustments made by the Tax Court and found by it and the Court of Appeals to be reasonable based on the evidence. Taxpayers' failure to keep records and furnish proof upon which the court could act made such estimates necessary.

2. Finally, taxpayers assert (Pet. 21–23) that the Commissioner did not sustain the burden of proof of fraud. There is ample evidence in the record to support the Tax Court's finding to the contrary.

As the Tax Court pointed out (R. 285a), both taxpayers are doctors of medicine and intelligent persons. Admittedly, they maintained no books or records from which their income could be determined.[5] Taxpayers' testimony was frequently vague and evasive. From time to time they varied their explanations of their assets and their net income was substantially understated in each of the taxable years. There is no justifiable basis in the record to treat either of the taxpayers separately or to treat the two interim years in which separate returns were filed any differently than the surrounding years in which joint returns were filed. Taxpayers' own testimony showed that each was familiar with the nature and scope of the other's medical practice and the extent of their other pooled financial operations. It is clear that the separate returns were prepared under no different theory or with any less collaboration or mutual awareness than the joint returns.

Whether the deficiencies were due at least in part to fraud with intent to evade tax,[6] as the Tax Court found (R. 285a), is, of course, a question of fact. In similar situations, the courts have uniformly held that imposition of fraud penalties was proper. *Halle* v.

[5] Records in the form of bank deposit statements and cancelled checks were entirely inadequate for this purpose.

[6] It will be observed that Section 293 (b) of the Internal Revenue Code of 1939, Appendix, *infra*, p. 20, expressly provides that if any part of a deficiency is due to fraud with intent to evade tax, the fraud penalty attaches to the entire deficiency.

Commissioner, 175 F. 2d 500 (C. A. 2d), certiorari denied, 338 U. S. 949; *Hague Estate* v. *Commissioner,* 132 F. 2d 775 (C. A. 2d), certiorari denied, 318 U. S. 787; *Boyett* v. *Commissioner,* 204 F. 2d 205 (C. A. 5th); *Goe* v. *Commissioner, supra; Archer* v. *Commissioner, supra; Mauch* v. *Commissioner,* 113 F. 2d 555 (C. A. 3d); *Thomas* v. *Commissioner,* 223 F. 2d 83 (C. A. 6th); and a host of other cases. This is not a case, as taxpayers mistakenly conceive it (Pet. 22), where fraud was based on mere understatement of income. This Court has said (*Holland* v. *United States,* 348 U. S. 121, 139) that evidence of a consistent pattern of underreporting large amounts of income, and of failure on the part of taxpayers to include all their income in their books and records is a sufficient basis on which to find fraud. Here, in addition to the other evidences of fraud, there was such a pattern and taxpayers kept no books or records at all from which their correct income could be determined.

The findings of the Tax Court, affirmed by the Court of Appeals, apply equally to both taxpayers herein, and amply demonstrate that the deficiencies in reported income on the part of each taxpayer for the years 1946 and 1947, as well as the years when joint returns were filed, were due to fraud with intent to evade tax. Under the facts herein, then, the courts below were fully justified in finding that the understatements were not due to mere inadvertence, negligence, or honest errors, and therefore properly sustained imposition of the fraud penalties for all the taxable years.

CONCLUSION

The decision of the court below is correct; there are no conflicts of decision, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

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26 U. S. C. 1952 ed., Sec. 21.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments

made to increase the value of any property or estate;

* * * * *

(26 U. S. C. 1952 ed., Sec. 24.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 51. INDIVIDUAL RETURNS.

(a) [As amended by Sec. 11 (a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *Requirement.*—Every individual having for the taxable year a gross income of $500[1] or more shall make a return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury. Such return shall set forth in such cases, and to such extent, and in such detail, as the Commissioner with the approval of the Secretary may by regulations prescribe, the items of gross income and the deductions and credits allowed under this

[1] This amount was changed to $600 by Section 202 (c), Revenue Act of 1948, c. 168, 62 Stat. 110, effective January 1, 1948.

chapter and such other information for the purpose of carrying out the provisions of this chapter as may be prescribed by such regulations.

(b) [As amended by Sec. 11 (a), Individual Income Tax Act of 1944, *supra*] *Husband and Wife.*—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several. No joint return may be made if either the husband or wife is a non-resident alien or if the husband and wife have different taxable years. The status of individuals as husband and wife shall be determined as of the last day of the taxable year.

* * * * *

(26 U. S. C., 1952 ed., Sec. 51.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To determine Liability to Tax.*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 276. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

* * * * *

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U. S. C. 1952 ed., Sec. 293.)

Internal Revenue Code of 1954:

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of

proof in respect of such issue shall be upon the Secretary or his delegate.

* * * * *

(26 U. S. C. 1952 ed., Supp. II, Sec. 7454.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.41–3. *Methods of Accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and section 29.54–1.) * * *

* * * * *

SEC. 29.54–1 [As amended by T. D. 5381, 1944 Cum. Bull. 188]. *Records and Income Tax Forms.*—Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Every organization exempt from tax under section 101 but required by section 54 (f) to file an annual return shall keep such permanent books of accounts or records, including inventories, as are sufficient to show specifically the

items of gross income, receipts, and disbursements, and such other information as is required by section 29.101–2. The books or records required by this section shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

Income-tax forms shall be prescribed by the Commissioner and shall be executed and filed in accordance with these regulations and the instructions on the form or issued therewith.

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